

# EXTENSIONS OF REMARKS

## SWAP FUND TRANSACTIONS

**HON. RICHARD E. NEAL**

OF MASSACHUSETTS

IN THE HOUSE OF REPRESENTATIVES

*Wednesday, August 4, 1999*

Mr. NEAL of Massachusetts. Mr. Speaker, today I am introducing legislation to eliminate a tax avoidance technique available only to the very wealthy. This technique involves the use of swap funds.

Like the legendary phoenix, a bird that lived for 500 years, burned itself to ashes on a pyre, and rose alive from the ashes to live again; this swap fund transaction has been closed down by Congress three times to date, only to see life again in the form of new and more exotic designs to get around whatever restrictions had been placed into law.

Legislation to shut down this particular practice was enacted in 1967, 1976, and again in 1997. In 1967, Congress enacted a law to prevent swap funds from being transacted in the form of a corporation, as was popular at the time. This led to the swap fund transaction being resurrected in the form of a partnership, which was closed down in 1976. Subsequently, the industry developed methods to get around both laws by manipulating the 80 percent test for investment companies. The Taxpayer Relief Act of 1997 closed these transactions down by broadening the definition of financial assets that are taken into account for purposes of the 80 percent test. Obviously, the point here is that three times Congress has acknowledged the tax avoidance potential of this transaction, and three times Congress has made a public policy decision to close this shelter down. And three times Congress has failed. We will not fail again.

Swap funds are designed to permit individuals with large blocks of appreciated stock to diversify their portfolio without recognizing gain and paying tax. In this transaction, a fund is established into which wealthy individuals with large blocks of undiversified stock transfer their stock. In exchange for the transferred stock, these individuals receive an equivalent interests in the fund's diversified portfolio. In effect, these individuals have now diversified their holdings by mixing their shares of stock with different shares of stock from other individuals, without having to sell that stock and pay tax on the gain like ordinary Americans.

The swap fund transaction is complicated, and is limited to individuals with large blocks of stock. For example, a recent offering was limited to subscriptions for \$1 million, although the general partner retained the right to accept subscriptions of lesser amounts. This, however, does not mean an individual with only a million dollars in stock could invest in the swap fund. In order to avoid Securities and Exchange Commission registration requirements, these transactions are often limited to sophisticated investors who under SEC regulations, according to a 1998 prospectus, must have total investment holdings in excess of \$5 million.

As outlined above, current law tries to stop swap funds involving a corporation or a partnership that is in investment company. An investment company is a corporation or partnership where the contribution of assets results in a diversification of the investor's portfolio, and more than 80 percent of the assets of which are defined by law as includable for purposes of this test.

In the most current form of the swap fund transaction, that limitation is avoided by holding at least 21 percent of assets in preferred and limited interests in limited partnerships holding real estate. In fact, the purpose of the fund is clearly identified by the prospectus, which states that "the value of the Private Investments will constitute at least 21% of the total value of the Fund's portfolio, so that the Fund will satisfy the applicable requirements of the Code and the Treasury Regulations governing the nonrecognition of gain for federal income tax purposes in connection with the contribution of appreciated property to a partnership." As in past years, the bill I am introducing addresses the specific transaction being used; that is, the bill would eliminate the latest avoidance technique by providing that such investments would be treated as financial assets for purposes of the 80 percent test.

The second part of this bill at long last recognizes the inadequacy of the above approach, given its 32 year record of failure. This section states that any transfer of marketable stock or securities to any entity would be a taxable event, if that entity is required to be registered as an investment company under the securities laws, or would be required to register but for the fact that interests in the entity are only offered to sophisticated investors, or if that entity is formed or availed of for purposes of allowing investors to engage in tax-free exchanges of stock for diversified portfolios.

The effective date of this legislation is for transfers after date of Committee action, with an exception for binding contracts signed prior to date of introduction. While it is clear that the Committee will decide on the appropriate effective date, I do not believe it would be fair to apply this legislation to contracts signed prior to the date that taxpayers were first on notice of a potential change in the law. This effective date is, by the way, similar to the effective date the Committee chose for the 1997 change.

For those taxpayers who react by rushing their deals, they should be on notice that I intend to attach this legislation to the first tax bill that emerges from the Committee on Ways and Means after September 1, 1999. For those who have technical suggestions to make to the legislation, it would behoove them for the same reason to analyze this bill carefully and make whatever technical suggestions they have as soon as they practically can.

Mr. Speaker, the life and death of this transaction is not simply another instance of American ingenuity and creativity which we can all admire. It is, in reality, a practical example of the need to seriously consider what generic

powers should be granted to the Department of the Treasury to close down certain tax shelters without waiting for Congress, which inevitably can only attempt to keep up with the most obvious techniques being utilized to minimize tax payments.

One of the great dangers I see on the horizon, Mr. Speaker, is that the proliferation of tax shelters will eventually lead to a severe backlash by Congress that may not be as well crafted as many, including myself, would like.

OFFICERS STEVE REEVES AND  
STEPHEN GILLNER

**HON. BOB BARR**

OF GEORGIA

IN THE HOUSE OF REPRESENTATIVES

*Wednesday, August 4, 1999*

Mr. BARR of Georgia. Mr. Speaker, those cynics who say America has no real heroes anymore have never heard the names Steve Reeves and Stephen Gillner.

Both men filled one of the most dangerous roles in the Cobb County Police Department by serving on its SWAT team. Late last month, both men gave their lives in a heroic effort to save an elderly woman.

Officers Gillner and Reeves were both devoted husbands and fathers. They were both active in their communities. Both had a record of putting their own lives at risk to help others.

Officer Gillner received an Officer of the Year nomination for pulling a man from a burning van. Reeves received awards for saving a family from a burning home and rescuing an officer from an armed suspect.

Every day, we are disappointed to see the sports figures and celebrities many look up to, letting us down. Officers Gillner and Reeves did not let us down. They lived their lives as quiet heroes; protecting lives, loving their families, and making it possible for the rest of us to enjoy the safety we all too often take for granted.

In life and death, these two brave officers taught all of us what it really means to be a hero. While nothing can erase their loss, we can take comfort in knowing they gave their lives doing a job they loved, and doing it well.

## WORKFORCE SKILLS SHORTAGES

**HON. DAVID DREIER**

OF CALIFORNIA

IN THE HOUSE OF REPRESENTATIVES

*Wednesday, August 4, 1999*

Mr. DREIER. Mr. Speaker, I rise today to commend the Chairman of the Immigration Subcommittee, Representative LAMAR SMITH, for recognizing the important role technology companies play in our nation's economy, and holding a hearing on Thursday to investigate the workforce shortage affecting America's high-tech industries. The high-tech explosion experienced in the U.S. has created over 1

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